

make sacrifices --- and they most surely will ---then the public is entitled to know what is coming.

Therefore, we recommend the City, as part of its annual CAFR, report (in a separate tabular form) the City's best estimate of material payments the City will be required to make for each of the next five years, and in the aggregate thereafter, as a result of (i) contractual commitments or (ii) other commitments the City reasonably intends to fulfill. These payments should include those for (i) expected contributions by the City to the pension plan for retiree pension benefits; (ii) expected payments the City will make for retiree healthcare benefits; (iii) capital expenditures resulting from contractual commitments; (iv) material contractual commitments in excess of one year; (v) deferred maintenance to the extent quantified; and (vi) debt and lease obligations. In the end, the presentation of the information in this form should provide citizens and investors with a credible, transparent picture of the demands on the future cash flows of the City.

12. BOARD COMPOSITION

The Audit Committee believes the City of San Diego Pension Reform Committee's recommendation to improve the governance of SDCERS by changing the size and composition of its Board was substantially correct. The composition of the Board should be comprised of qualified professionals with experience in the management of investment funds, as well as an understanding of and commitment to the fiduciary responsibilities owed the System's retirees and employees. At the same time, it must be recognized that employees and retirees, whose contributions helped build the System's assets, have a direct financial interest in the system's welfare unlike any other, and that interest is deserving of respect. Accordingly, we believe the Pension Reform Committee's recommendation to increase the number of outside independent professionals on the Board is an improvement, but further improvements are necessary.

The composition of the Board of Administration of SDCERS should consist of nine members, including five members who shall be appointed by the Mayor and confirmed by the City Council. We believe a nine-member Board is small enough to encourage collaboration and collegial exchange of views, yet sufficient to oversee the retirement plan and the work performed by the approximately 60 employees of SDCERS. Mayoral appointees shall have the qualifications otherwise specified in the City Charter. The remaining four members should consist of: (i) two members elected from police safety members, fire safety members, or general members of the retirement system, selected in accordance with Charter Section 144(d); and (ii) two retired members of the retirement system, selected in accordance with Charter Section 144(e).

Given its precarious funding and rancorous history, the process of identifying and evaluating prospective SDCERS Board members should be undertaken with greater care. In connection with SDCERS Board vacancies in 2005, the Audit Committee observed that applicants for appointment were considered by the prior administration on the basis of incomplete, unsigned written forms and inadequate background investigations. In more than one instance, a routine background check performed at the Audit Committee's request revealed that the applicant had been associated with an entity that had been the subject of a regulatory

investigation. We therefore recommend that, prior to any appointment being made to the SDCERS Board, each potential appointee be required to complete a written application listing qualifications for the position and any factors that may impact on that decision, and that the applicant be required to affirm the accuracy of the application. A background check of the applicants to be nominated should be done by the appropriate City department. The applications should also be shared with the Business and Governance Committee of the SDCERS board.

13. BOARD COMMITTEES

The Board of Administration should have standing committees to address board governance, compensation and evaluation of the Retirement Administrator, investments, and an audit and compliance committee. We understand that the SDCERS Board has already consolidated its former Business and Procedures Committee with its Rules Committee to form a single Business and Governance Committee, and has reconstituted its Audit Committee so that three of its five members will be formally experienced non-Board member citizens of San Diego, one of whom will serve as chair.

The Board should adopt and publish a formal charter for each of these committees, which should be updated no less frequently than every three years. The charters should ensure the committees perform a board and committee evaluation process on an annual basis. The annual SDCERS CAFR should include a report from each of these committees on significant activities during the year.

14. SDCERS CAFR

The Retirement Administrator and CFO of SDCERS should annually include in the SDCERS CAFR a signed management report on the financial statements which should include: (i) a statement of SDCERS's responsibility for establishing and maintaining an effective system of internal control over financial reporting and disclosures; (ii) a statement setting forth SDCERS's assessment of the effectiveness of the internal controls as of the Plan's fiscal year end as well as identification of any material weaknesses in internal controls; (iii) a statement that, based on their knowledge, the CAFR does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the CAFR, in light of the statements made and circumstances under which they are made, not misleading with respect to the period covered; (iv) a statement that the staff of SDCERS and its Board of Administration are responsible for the adoption of key assumptions used by the SDCERS actuary in the valuation of the system's assets and liabilities; and (v) a statement that the financial statements and other information included in the SDCERS CAFR fairly present in all material respects the net assets and changes in net assets of the Plan for period presented.

15. SDCERS FINANCIAL AND ACCOUNTING COMPETENCY

In the past, SDCERS has lacked sufficient resources to perform its accounting: the SDCERS accounting function has been a mixed responsibility of city personnel and SDCERS. We understand that SDCERS has recently decided to create a full-time Internal Auditor staff position that will report directly to the Audit Committee; a Compliance Officer staff position